DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

36 Letters per Year — $75 Annually

Registered with the Securities Exchange Commission

May 2, 1973 Letter 562

April 19, DJIA 963.20, PTI 846, A-D ratio -9.28
April 27, DJIA 922.19, PTI 816, A-D ratio -10.79

SPECIAL REPORT: I am taking up most of this report with one of my "secret" pet studies, the Elliot Wave Principle and its application to the market and individual stocks. I feel that this is a good time to present the study. My subscribers are out of this horrendous market, thereby avoiding crushing losses. They are in the gold shares, which means that they are participating in a once-in-a-lifetime (or in two lifetimes) bull movement in the "king of metals." Yet there is no rest for the market student, and that little voice is saying, "Russell, get on that typewriter. If your subscribers are out of the market and in gold shares, they're probably happy and receptive enough to do some real work." Consequently, I give you Elliot.

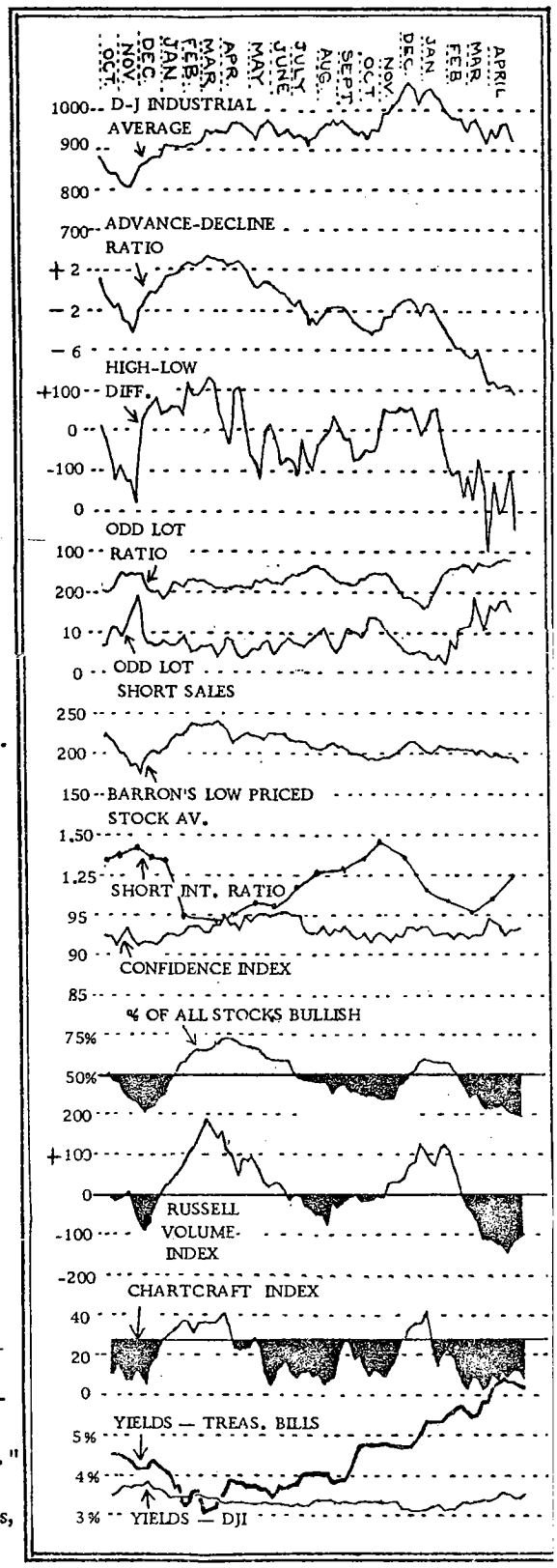
Before plunging into Elliot, however, I want to present the following in the form of a market diary: April 19: DJIA gives a #2 major sell signal as the 13-week moving average of the Dow drops below the 50-week MA (see Letter 561). April 23: The Primary Trend Index (PTI) breaks to a new 1973 low, a low which is below the 1972 and 1971 low (I warned about the weak PTI performance in the last Letter). April 24: The A-D ratio sinks to a fresh primary bear market low, below everything seen since the 1940's!

April 25: D-J Transports decline to a new 1973 low, as Letter 561 warned they might. April 25: PTI, A-D ratio and Transports decline to new lows. Transports turn viciously negative as they give a new point & figure bear signal, a signal which occurs below the long-term rising trendline as seen in Letter 556, page 2 (once again, I urge all subscribers to keep back Letters. I cannot possibly repeat all previous charts in each report, but I do refer to them constantly). Critical point for the market, the 910.45 DJIA low, a low touched by Industrials in July 1972 (see Letter 559, page 3).

Meanwhile, the gold shares were advancing to new all-time highs. Nothing in the gold volume, however, suggested that the public was buying the golds. So far, I feel that we are seeing early professional buying in the golds (in the current issue of Forbes (May 1, page 56) a pussyfooting fund manager actually apologizes for having placed 5% of the fund's assets in gold shares!)

But the most exciting thing in the gold share picture is this. Unknown to almost everyone, the four listed golds (ASA, CRK, DM and HM) have now attracted short positions. The March figures show ASA with 11 thousand shorts, CRK 12 thousand, Dome 14 thousand, Homestake 24 thousand. For April HM jumped to 29 thousand, and I do not have the other figures yet. Thus the stage is slowly building for a spectacular running of the gold shorts as the primary bull trend in golds pulverizes everything that stands in its path.

ELLIOT WAVE: Anyone who spends a decade or so around the stock market eventually hears the expression, "Elliot Wave Principle." Yet, not one in a thousand has any useful understanding of the Wave Principle. In 1939 Financial World published a series of articles by R. N. Elliot in which Elliot (on the basis of studies of 80 prior years of market action) formulated certain theories regarding "natural movement." Elliot began his series with the following sentence, "Since the beginning of time, rhythmic regularity has been the law of creation." Elliot then went on to describe these rhythms or cycles, and in his studies he demonstrates that these natural rhythms occur in the "tides, the heavenly bodies, cyclones, day and night, even life and death!"



Following Elliot's death in 1947, a few intrepid students continued the studies formulated by Elliot. One of these men was Garfield Drew (of odd-lot fame). In his book, "New Methods for Profit in the Stock Market," Drew outlines Elliot's theories, and I want to say while I am at it that Drew's book represents one of the milestones in stock market literature (Jeff, take a bow, because I don't feel you have ever received the real credit you deserve for that book).

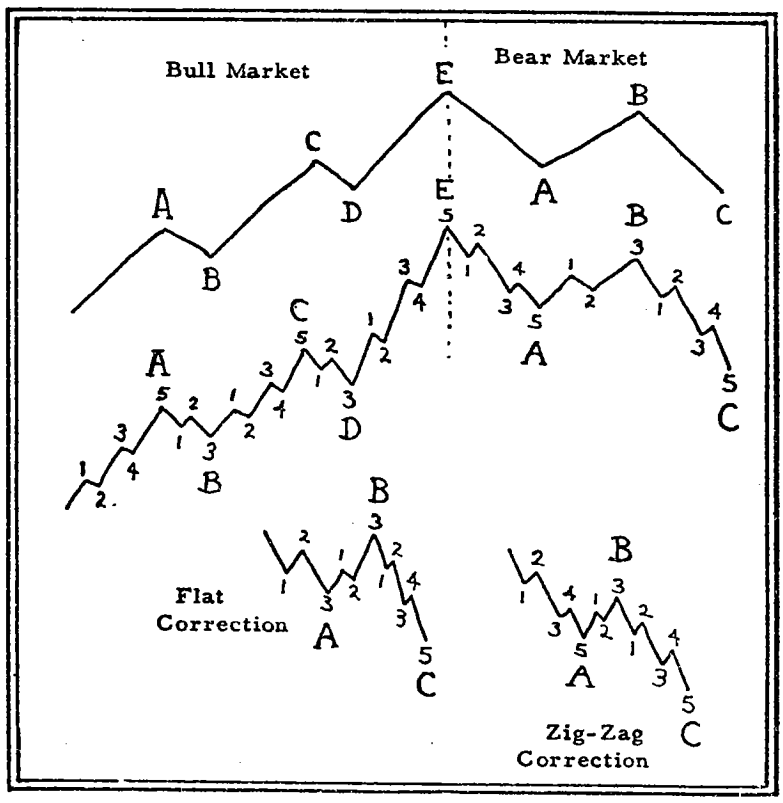
Hamilton Bolton, founder of the authoritative Bank Credit Analyst (and a brilliant market student) was an avid follower of the Wave Principle. In 1960 Bolton published his classic volume, "The Elliot Wave Principle." I have been interested in the Wave Principle since the mid-1950's, and I had been corresponding with Bolton prior to the publication of his book. Naturally, I was most pleased to have that book, and I think I spent a solid month literally memorizing every line in it. (Ham Bolton died a few years ago, and with his passing went the leading student of Elliot).

I have not mentioned Elliot very often in these reports; I did in 1968 when I called for a breaking (by the Dow) of the 1966 low, and I did in 1964 when, with the help of Elliot, I picked Burroughs as a buy near its extreme low of 20. Since 1968 I have revised many of my interpretations of Elliot and the market (Elliot revisions are necessary at times), and I have been wanting to present the whole fascinating Elliot Principle again. But it is such a difficult and massive study, that I have simply been putting it off. At any rate, I do want to familiarize my subscribers with the Wave concepts, so here goes (remember, this is, of necessity, a very simplified and abridged presentation).

I will start by saying that Elliot ties in with an extraordinary numerical series, a series which is seen repeatedly in nature. This is the Fibonacci series, so named for a famous thirteenth century Italian mathematician. The Fibonacci series is computed as follows: Start with 1 and add the next number to get the total or Fibonacci number. Thus, 1 and 2 equals 3, 3 and 2 equals 5, 5 and 3 equals 8, etc...all of which gives us the Fibonacci series 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, etc. These numbers appear so often in nature that we must conclude it is far beyond mere coincidence; for instance, one God, 5 limbs of man (head, two arms, two legs), 5 openings in the face (two eyes, two nostrils, mouth), we knock 3 times, 5 continents, 21, the age of maturity, trees always branch from the base in fibonacci series, on and on. It's simply amazing!

So much for the numerical series. Elliot discovered that stocks advance in broad bull markets composed of 5 legs as shown on the chart, and they correct in bear markets composed of 3 legs. Furthermore, each of the 5 bull market waves break up into 21 sub-waves. A bull market is composed of 5 sub-waves up, a 3-wave correction, a second 5-waves up, a 3-wave correction, and a final 5 sub-waves up (see chart, bottom of page).

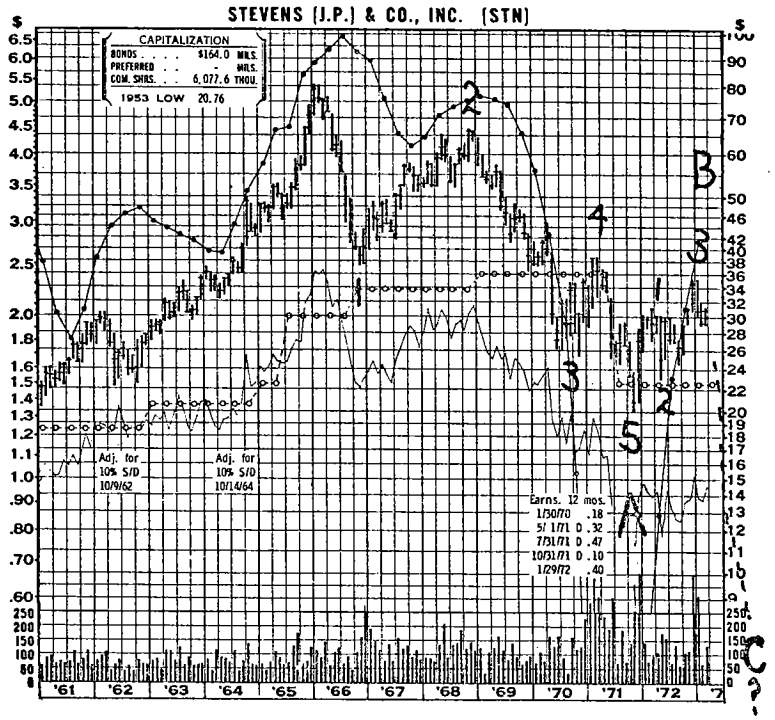
There are many complexities in the Wave Principle, and it is now necessary to explain one of them. It is the Elliot interpretation of corrections. There are two kinds of corrections (or bear markets) following a bull movement. One correction is termed the zig-zag (see chart), and the other is called the flat. A zig-zag is made up of 5 sub-waves down, 3 up and 5 down. By definition, the peak of the leg 2 is below the start of leg 1, and this means, of course, that zig-zags are the most severe kind of correction. The flat is a 3 sub-wave down, a 3 up and a 5 down. Usually the peak of wave 2 is near or even above the start of wave 1, so that flats tend to be milder corrections than zig-zags. They are also (fortunately) much more common.



This whole concept provides us with many valuable principles. In order to explain some of these principles I am going to use actual charts. I find the most useful are monthly graphs showing very long-term movements (logarithmic charts courtesy of Securities Research, 208 Newbury St., Boston, MA 02116, arithmetic charts courtesy of Horsey, Salisbury, MD 21801). Actually, there are instances when log charts will show Elliot movements best, at other times arithmetic charts will provide best results.

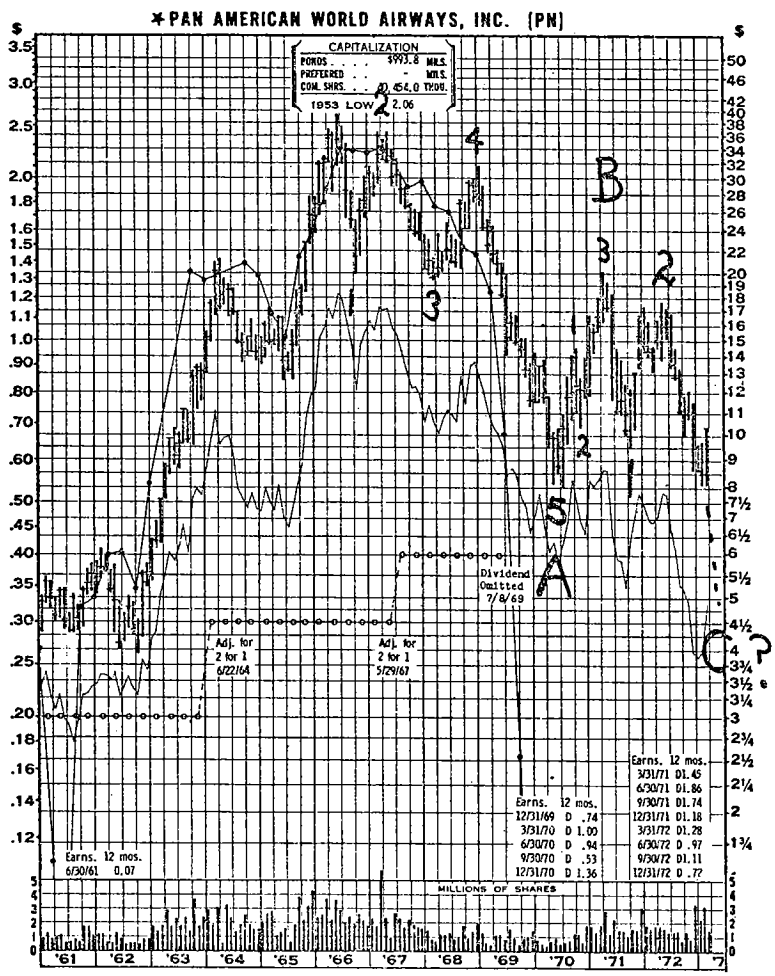
Remember, Elliot is not a magic way of beating the market. Using Elliot correctly may require years of study. Not all charts will show anything on a wave interpretation basis. Often a stock will appear unanalyzable, but an examination of other stocks in the group may provide hints. In general, I do not "force" Elliot interpretations. There are always a number of near-perfect charts for interpretation, and I use them while avoiding the "un-decipherable" ones.

Back to the practical principles. Let's take the chart of J. P. Stevens (STN). Note that STN has collapsed from its 1966 peak of over 80 in a series of 5 distinct waves. The 5th wave took STN to a 1971 low of 20, a total loss of about 80% of its peak value. Now, what do we know? We know that the Wave Principle states that bear market corrections take the form of 3 waves down. But there is no way we can get a 3 count out of the 1966-70 collapse in STN, it occurred in 5 waves.


STEVENS (J.P.) & CO., INC. (STN)
CAPITALIZATION
BONDS . . . $164.0 MILS.
PREFERRED . . . - MILS.
COM. SHRS. . . 6,077.6 THOU.
1953 LOW 20.76
Adj. for 10% S/D 10/9/62
Adj. for 10% S/D 10/14/64
Earns. 12 mos.
1/30/70 .18
5/1/71 D .32
7/31/71 D .47
10/31/71 D .10
1/29/72 .40
'61 '62 '63 '64 '65 '66 '67 '68 '69 '70 '71 '72

This suggests that the 1966-70 5-wave collapse in STN was not a completed bear market, that it was all part of wave 1 of a huge 3-wave bear market which I have marked A-B-C. Furthermore, it appears that the A wave was completed (in 1970), the B wave is about over (B was a 1-2-3 which ended around January, 1973). We should now get another 5-wave decline which will be major leg C in the major A-B-C bear market in STN, a bear market in the form of a zig-zag of the 5-3-5 variety. Prognosis: Avoid STN.

Unfortunately, the pattern in STN is rather common in this market! It appears in many, many stocks. And if my Elliot interpretation is correct, those patterns indicate vastly lower prices for many equities. Let's take another stock, Pan American World Airways (PN). Here it appears that the stock is more advanced into its bear market. PN has completed a 5-wave down from its 1966 peak of 40. This 5-leg down completes major leg A of a potential A-B-C bear market. Leg B was completed in a 3-wave up. It now appears that PN is on leg 3 of the final major leg C, a leg which could take it well below the 1970 low of 8. Obviously, this kind of pattern in PN does not bode well for the airlines. And since the airlines make up a good part of the D-J Transport Average, this chart hardly bodes well for the entire market.

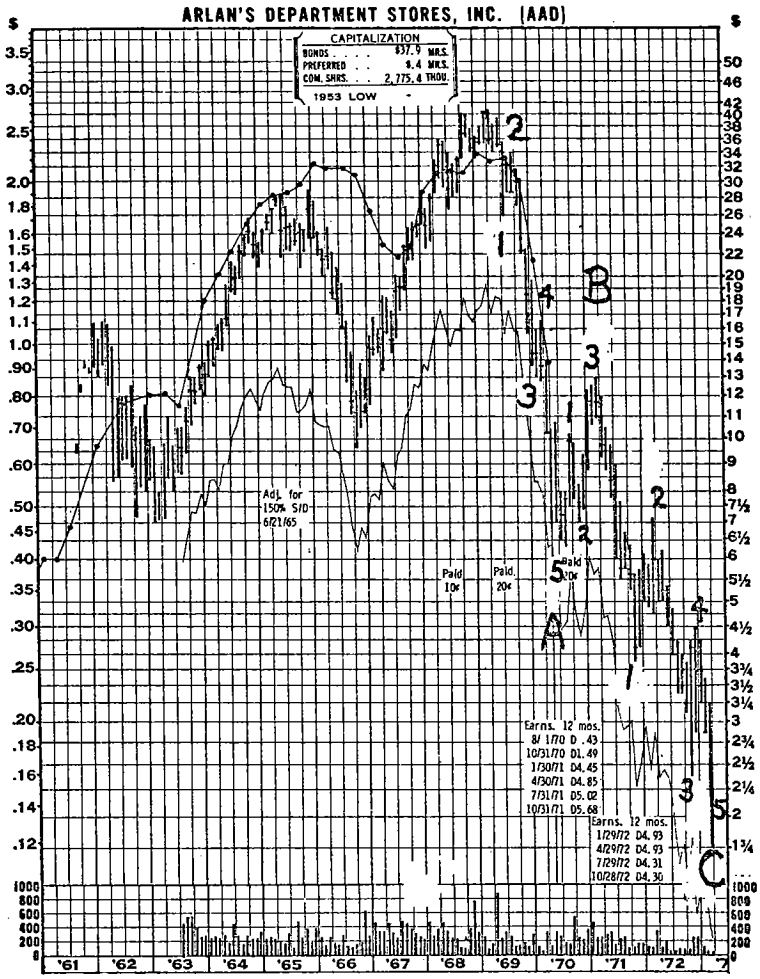


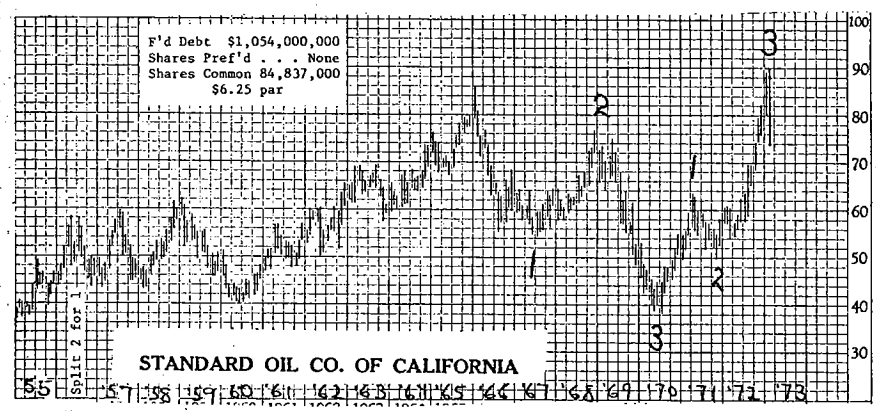
Let's take a third example, on the top of page 4, Arlan's Dept. Store (AAD). Here we see a disastrous cave-in from the 1969 high of 40 to a 1973 low of 2. It appears that we have a full bear market smash here, a completion of a giant A-B-C pattern in the form of a series of 5-3-5 waves down. What happens next at AAD? Well, based on the chart and the situation of the company (running at a deficit), I would have to say that either the bear market is over, or it's about all over for AAD. The stock can't get much cheaper, and the company will either start a new life, merge, or go out of business. Those who followed Elliot would not possibily have ridden this stock down.

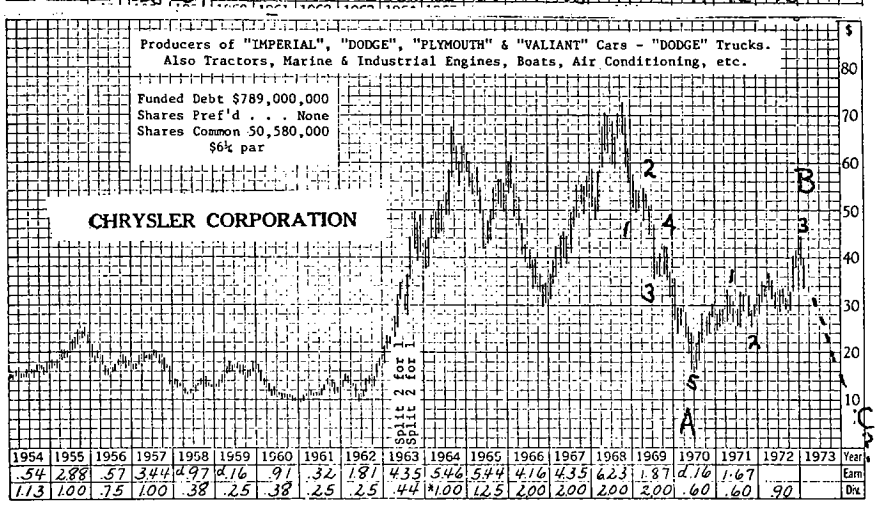
Should one take a chance and figure the worst is over for AAD? Should one buy it here at this price? That's a whole different story. For that I would want much varied evidence that the company will survive, that this is the final bottom, etc.

Let's turn to Standard of California (SD). Here we see that SD completed a perfect major 3-wave bear market during 1966-70. A new bull market took SD to an all-time high of 90 this year in 3 distinct waves. What can we say of SD now? It would seem that we could now be in a corrective wave 4 in SD, and following this correction a final wave 5 should take SD to new highs. Furthermore, it would seem that wave 4 should hold above the peak of wave 1 or above 65 on any major corrective decline from here. Why is SD so strong in the face of the smash in so many other stocks? There could be a hundred reasons, but Elliot doesn't concern itself with reasons. The Wave Theory couldn't care less whether the chart shown was one of SD or the price of wheat in Kansas.

Next I will show Chrysler. I cannot get a 3-wave count on the decline in Chrysler from the 1973 peak of 73 to the 1970 bottom of 16. If my 5-wave count



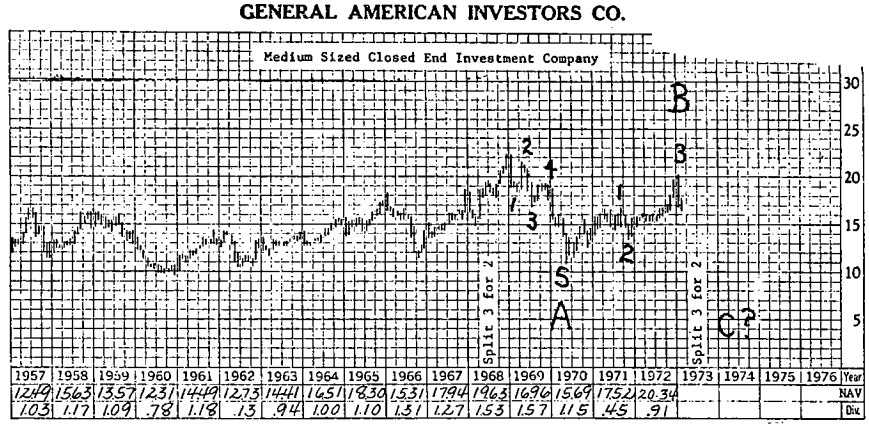

F'd Debt $1,054,000,000
Shares Pref'd . . . None
Shares Common 84,837,000
$6.25 par
Split 2 for 1
STANDARD OIL CO. OF CALIFORNIA
55 57 58 59 60 61 62 63 64 65 66 67 68 69 70 71 72 73


Producers of "IMPERIAL", "DODGE", "PLYMOUTH" & "VALIANT" Cars - "DODGE" Trucks.
Also Tractors, Marine & Industrial Engines, Boats, Air Conditioning, etc.
Funded Debt $789,000,000
Shares Pref'd . . . None
Shares Common 50,580,000
$6¼ par
CHRYSLER CORPORATION
Split 2 for 1
Split 2 for 1
1954 1955 1956 1957 1958 1959 1960 1961 1962 1963 1964 1965 1966 1967 1968 1969 1970 1971 1972 1973 Year
.54 2.88 .57 3.44 d.97 d.16 .91 .32 1.81 4.35 5.46 5.44 4.16 4.35 6.23 1.87 d.16 1.67 Earn
1.13 1.00 .75 1.00 .38 .25 .38 .25 .25 .44 *1.00 1.25 2.00 2.00 2.00 2.00 .60 .60 .90 Div.

is correct, then the 1968-70 decline in Chrysler constituted wave A of a giant A-B-C bear market. If this is true, then the rise from the 1970 bottom to the present was middle wave B, and I would guess that the B wave is about completed. This suggests that wave C, which should be a 5-wave down, lies ahead. Since the bear market in Chrysler is taking the form of a zig-zag correction (5-3-5 waves), then leg C should take the stock well under its 1970 price of 16.

In his research on individual stocks, Ham Bolton wrote, "One further suggestion would be to study the Wave Principle in relation to closed-end investment companies." OK, Ham, here goes. Obviously, closed end trusts should tend to reflect the general market fairly closely, and if we can decipher the message in the trusts, we might be able to forecast something about the whole "market" situation. I am including a page 5 chart of General American Investor (GAM), a well-known trust which happens to have a fairly clear wave

pattern. I can only count the movement down from the 1968 peak of 22 to the 1970 low of 9 3/4 as a 5-wave down. There is no way I can get a 3-wave out of that movement (obviously, a 3-wave would be more pleasant since it would at least offer hope that the bear market in GAM and on Wall Street in general could be drawing to a close).


GENERAL AMERICAN INVESTORS CO.
Medium Sized Closed End Investment Company
Split 3 for 2
Split 3 for 2
1957 1958 1959 1960 1961 1962 1963 1964 1965 1966 1967 1968 1969 1970 1971 1972 1973 1974 1975 1976 Year
NAV
Div

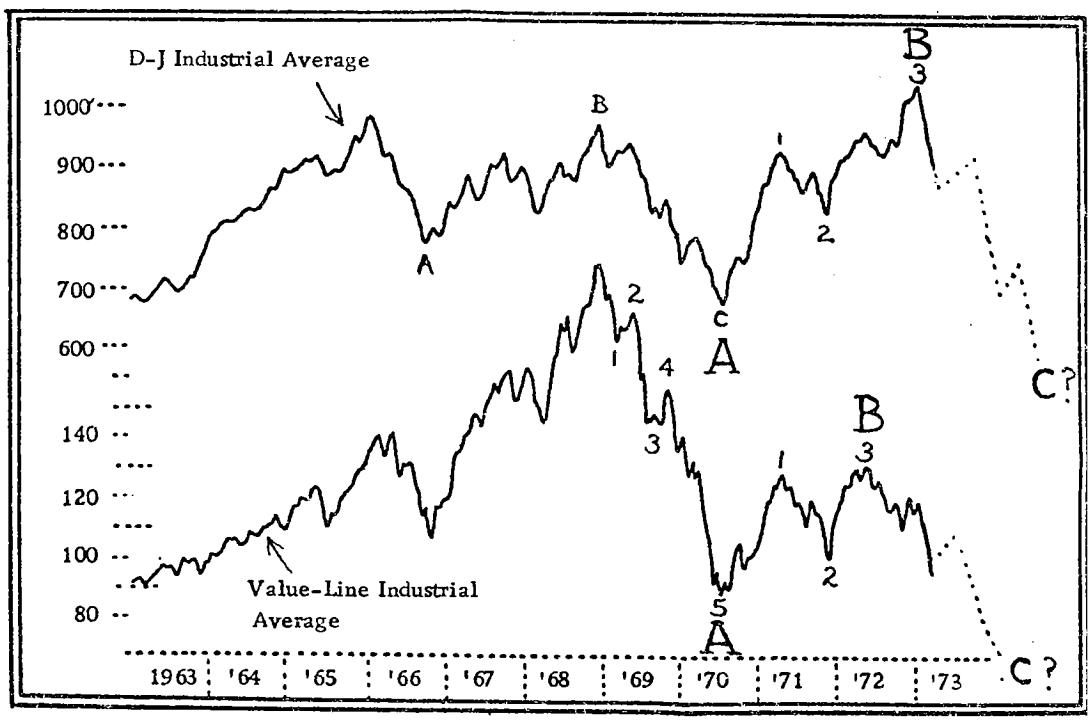
Unfortunately, I cannot get an A-B-C count for the 1968-70 decline in GAM. Such a count would imply that a bear market had been completed. Actually, the 1968-70 cave-in took the form of 5-waves, numbered 1 to 5 on the chart. I have designated these 5 waves major wave A on the chart. Major wave A should be the first wave of a major A-B-C bear market correction. Next, note the advance to the January, 1973, peak of 20 in GAM. This advance breaks down into 3 waves, and these should complete larger wave B. So, what do we know overall? We know (or at least guess) that GAM is in a zig-zag type bear market which will ultimately be completed in three major waves, A-B-C, of the 5-3-5 sub-wave series. Downward major wave C (which should be composed of 5 sub-waves) is probably now in progress.

Since GAM is an investment trust, this may tell us something about the general market. Now any idiot knows that the market is composed of many stocks (all in different stages of Elliot Wave patterns), but the broad implication would be that the majority of stocks are in patterns corresponding to the pattern in GAM. Thus, we can be prepared for a movement in which many, many stocks will decline in the C leg of major A-B-C primary bear markets. If my Elliot Wave interpretations are correct, the warnings are there aplenty.

Next, I want to discuss the Dow itself in Elliot terms. For this I am including my chart of the Dow and the Value-Line broad unweighted Industrial Average. I am using the 1966 peak as the point in which the 1949-66 bull market ended for the DJI. This corresponds with my Dow Theory studies, and it agrees with Ham Bolton's studies. Before I go into this I find it necessary to present a few Elliot Wave "rules" or observations.

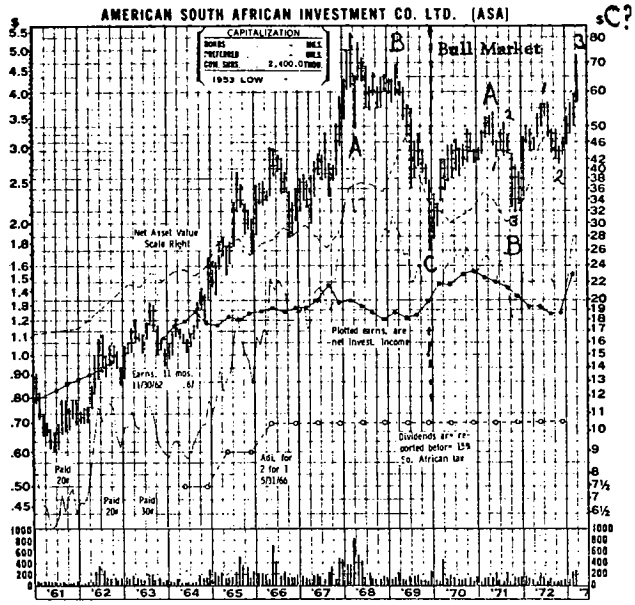
1. Wave 3 is usually the longest wave.
2. Wave 4 should not dip below the peak of wave 1.
3. The first wave of a series (even in corrections) is usually the shortest.

Studying the Dow on the chart, one might say that a bear market ended in 1970, in an A-B-C zig-zag down (small A-B-C on the chart). If that were true, then it would also follow that a new bull market started at the 1970 low. All right, then the first wave up would be the rise from the 1970 Dow low of 631.16 to the 1971 peak of 950.82 or wave 1 on the chart. Wave 2 would be the 1971 down-wave marked 2 and wave 3 would be the 1973 advance to 1051.50. We would now be in corrective leg 4 with leg 5 still to come, a leg which should take the Dow to new highs.



BUT...Note that the 1973 leg 4 took the Dow below the peak of

leg 1 (below the 1971 peak of 950.82). Rule 1 of the Wave Theory states that wave 4 should not dip below the peak of wave 1. Something is wrong. And here is how I interpret the action. I believe that the decline from the 1966 peak to the 1970 low was wave A (large A on chart) of a massive A-B-C wave bear market, a bear market which is assuming the shape of a "flat." The rally to the 1973 peak constitutes major wave B (large B on chart) of the corrective flat, and this wave actually rose slightly above wave A, which is not atypical of flats. These first two waves are the 3-3 waves of a total 3-3-5 bear market correction. We are now in the major downward wave from B to C, a wave that should take the form of a 5-wave down. This will complete the bear market, and wave C should terminate below major wave A (or below 631.16 on the Dow).



As for the Value-Line Average, I can only get a 5-wave count for the 1968-70 decline. This suggests that a bear market began in 1968 for the Value-Line Industrials, and the first major leg (A) was completed at the 1970 low. A 3-wave correction carried to the 1972 peak (completing major wave B), and we are now at the beginning of major down leg C. Note that the Value-Line bear market is in the form of a distinct downward zig-zag, and thus will provide a much more severe bear market than the flat pattern bear market in the Dow. This would explain the crushing collapses in so many non-Dow stocks, compared with the relatively resistant performances of the Dow Industrials. We should now be in the major C leg of the bear market in Value-Line, a leg which will subdivide into 5 waves (the low for Value-Line should be well below the 1970 low).

Finally, I want to present a gold stock in terms of Elliot, and I have selected American S. African Investment Trust (a gold share holding Co.). The chart shows the bull market in ASA which took the stock from 9 in 1961 to 82 in 1968. During 1968-70 ASA underwent an A-B-C correction which took it back to 26. I have labeled the action since then (the action which began n early 1970) as "Bull Market" on the chart.

The first major leg of the new bull market (A on chart) took ASA to the 1971 peak of 54. A typical 1-2-3 correction followed, taking the stock back to 32 and thereby completing major corrective leg B. Major leg C commenced from the 1971 low. The first sub-wave of wave C (marked 1 on chart) ended at the 1972 peak of 57. Then came a drop to the late 1972 low of 41, and this is marked 2 on chart. Most recently, we have the rise to the 1973 peak above 75, and this I have marked 3 on the chart.

Now the question, why couldn't one claim that the move from the 1970 low to the current high constitutes a 5-major wave bull market which is now about completed? I reject this interpretation on two counts (1) corrective leg 4 dropped far below the peak of leg 1, and this should not occur in an Elliot pattern. (2) The first leg (A) should be the shortest leg. Thus, current leg C should be much longer than leg A, and I am of the opinion that the current major leg C will develop as a 5-sub wave rise with ASA now perhaps nearing completion of its 3rd sub-wave. We should then have a correction (sub-wave 4), then a final very speculative sub-wave 5 up. Following that, a major correction should arrive, a correction which will constitute major leg D. Last, we should again witness a major up-wave E made up of 5 sub-waves.

That should complete the entire bull market in ASA. At this writing, no one can tell where that final peak for ASA will be, but it should be much, much higher than anything even the optimists now envision for this stock.

PARALLELS: Subscribers have been wondering why the Administration doesn't move to set a realistic price on gold. I'll repeat my rule, "Politicians don't set the trend of events, the events move the politicians." Look at Watergate. The Administration had to literally fall apart in an unbelievable labyrinth of lies and payoffs before President Nixon would even admit to anything being wrong. Public polls and a national tidal wave of resentment finally bumped Mr. Nixon and Republican leaders out of their ivory towers. And we want action on gold? The longer Watergate was brushed aside, the worse the final scene. It will be the same with gold. The longer the Administration looks the other way, the higher the ultimate "price," both monetarily and otherwise.

LATE NOTES: On April 27 the Industrials, Transports, A-D ratio, and PTI all smashed to new 1973 lows. The 910.45 Dow low is the last line of defense; if this goes the entire market structure will be ripped apart. The consensus is that the market is "crazy," going down in the face of whopping earnings because the little fellow has left Wall Street and confidence is crumbling. My view: There is validity in both of those views, but the real reason for the market collapse is that it is discounting a major recession or depression ahead.